Rethinking growth strategies in LICs: the need to achieve strategic planning and political stability

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The Problem: Most policy debates on industrial policy are technical, apolitical and ahistorical

Industrial strategies can be seen as specific sets of policy tools designed to develop new capabilities that will shift the economy from less sophisticated sectors with lower productivity to more sophisticated sectors with higher productivity. This process is generally known as structural transformation. Why these transformations matter is simply because 'poor countries become rich ones by producing what rich countries produce' (Rodrik, 2010).

In the context of late development, which is inherently risky and lacks private long-run financing organisations, advocates of state intervention point to the benefits that industrial policy can have in inducing learning and technology acquisition (Amsden, 1989, 2001; Wade, 1990; Cimoli et al., 2009). This literature has provided an important contribution by highlighting the salience of targeted subsidisation, or rent-creation, in driving the late industrialization process.[1] It has also emphasised that effective industrial policy is essentially a system of 'carrots and sticks', in which continued privileged subsidisation needs to be conditional on performance criteria, especially improvements in productivity (Amsden, 2001).

While the purely economic arguments for the benefits of state intervention may be accepted, too little attention is paid to where the power to mobilise resources, implement policies and prioritise policy goals comes from in the first place (Kohli, 2004). As a result, developmental state analyses do not explain why similar types of industrial policy can *fail* in many contexts. Moreover, technical policy advice in this view fails to explain why the *forms* of effective

[1] Such policies include: vertical policies to select strategic targets (winners) and concomitant nationalisations, high import tariffs followed by import licensing regimes, selective and subsidised credit access, tax exemptions, favourable access to foreign exchange, regulations on national content requirements, stimulation of technology transfer and complementary FDI, and export subsidies (Khan and Blankenburg, 2009: 359).

industrial policy differ so much across countries, why particular industrial policies, even when effective in one country, are not transferable across political systems (Rodrik and Subramanian, 2003), and why some sectors perform better than others *within* countries (Di John, forthcoming).

Based partly on the failure of many countries to effectively design and implement industrial policies, mainstream policy advice does not promote the use of industrial policy, especially when it concerns low income countries. Advocates of laissez-faire suggest that centralized, interventionist and discretionary industrial policies have led to corruption and cronyism, which have, in turn, hindered growth-enhancing competition (e.g. Krueger, 1974).

Even when it is acknowledged that, in theory, successful state management of industrial policy might have worked in a handful of countries, especially in Northeast Asia (World Bank 1997), the standard advice to sub-Saharan African economies would be "not to try this at home" since the capacity to effectively administer subsidies, export "contests" and investment co-ordination is generally lacking. Otherwise, the proponents of liberalisation would argue that there would not be so many infant industries that failed to "grow up".

Inherent in this reasoning is that effective industrial-policy states are "idiosyncratic" forms of late development and therefore unlikely to be replicable in other contexts whereas more decentralised, liberal forms of capitalist development represent a more natural fit. In this perspective, economic liberalisation becomes a pragmatic 'second-best' solution in light of the supposed weakness of state bureaucracies that cannot avoid the dangers of political capture and thus result in inadequate and poorly targeted resource mobilisation efforts, which have undermined so many industrial policy initiatives in the past.

There are several problems with this neo-liberal argument. First, there is little cross-country or time-series evidence that accelerations in the growth trajectory of countries have been *preceded* by wide-ranging economic liberalization (Rodrik 2004). Second, *comparative* regional evidence suggests that where liberalisation reforms have been most pronounced (i.e., Latin America and sub-Saharan Africa), manufacturing performance has been disappointing (MacMillan and Rodrik, 2011). While the state in many African economies may have failed to generate and implement growth-enhancing regulatory structures, market liberalization does not eliminate the market failures and risks of late development that justified state intervention in the first place. Third, the idea that controlling corruption or more generally introducing 'good governance' reforms is central to improving growth (World Bank, 1997) has very little empirical support (Khan and Jomo, 2000; Svensson, 2005). Thus, the key analytical challenge is to explain why some countries are able to create more developmental outcomes in the context of 'clientelism' and corruption while other states do not.

While the concerns raised by neo-liberals are legitimate, they do not apply only to "industrial policy." Indeed many governments have misused monetary and financial regulatory policy, infrastructure policy, or education policy. But few analysts would argue that, as a result, governments should abandon the use of such policies (Stiglitz et al., 2013: 7). It is therefore imperative to understand the circumstances under which industrial policies will work, and the forms of industrial policy that are appropriate for countries in different stages of development and with different political and economic institutions.

Moreover, because fiscal resources and implementation capacity can be limited, governments need to prioritise and decide which particular sector and its accompanying infrastructure that they should improve or where they should optimally locate the public services to make those success stories happen. Scarcity of state resources and competing demands on those resources imply that government leaders, in conjunction with private- and public-sector managers, need to make difficult choices with regard to which sectors to develop and how to effectively monitor them.

Taking political economy seriously

The failure of many governments to design and implement industrial policy needs to be taken seriously. Neither the neo-liberal nor the developmental-state literature makes politics central to an understanding of the variation and change in state capacity to intervene in the economy in growth-enhancing ways. The main problem of political economy is to understand the relationships between the two main factors that influence the political survival of leaders: a) maintaining a non-violent political order and b) promoting economic development (including structural transformation and employment creation).

The establishment of political order and peace, as argued by North et al (2007), requires the creation of incentives for groups to compete for resources through non-violent mechanisms. The principal solution throughout history to the classic Hobbesian problem of endemic violence is the creation of what can be called *limited access orders* (as opposed to the much rarer open access orders, which characterise advanced market economies). The limited access order creates limits on the access to valuable political and economic functions as a way to generate rents.[2]

In this model, the ruling coalition creates opportunities and order by limiting to elite groups the access to valuable resources--land, labour and capital--or access to and control of valuable activities--such as contract enforcement, property rights enforcement, trade, worship and education. When powerful individuals and groups become privileged insiders and thus possess rents relative to those individuals and groups excluded (and since, in addition, violence threatens or reduces those rents), such a privileged position induces the 'privileged insiders' to cooperate with the coalition in power rather than to fight it. In effect, limited access orders create a credible commitment among elites [3] that they will not fight one another.

While political order is a necessary condition for political survival, it is generally not sufficient. This brings us to the other important role of subsidies and rents, which is to induce learning and late development, as emphasised by developmental state theorists (as discussed above). Thus, the role of subsidies and rents has a *dual* role, as seen in Figure 1.

The key issue in the political economy of industrial policy is to explain how and why the process of maintaining political order affects economic growth through an interactive process. *The danger for most low-income countries is that the deployment of rents and subsidies will*

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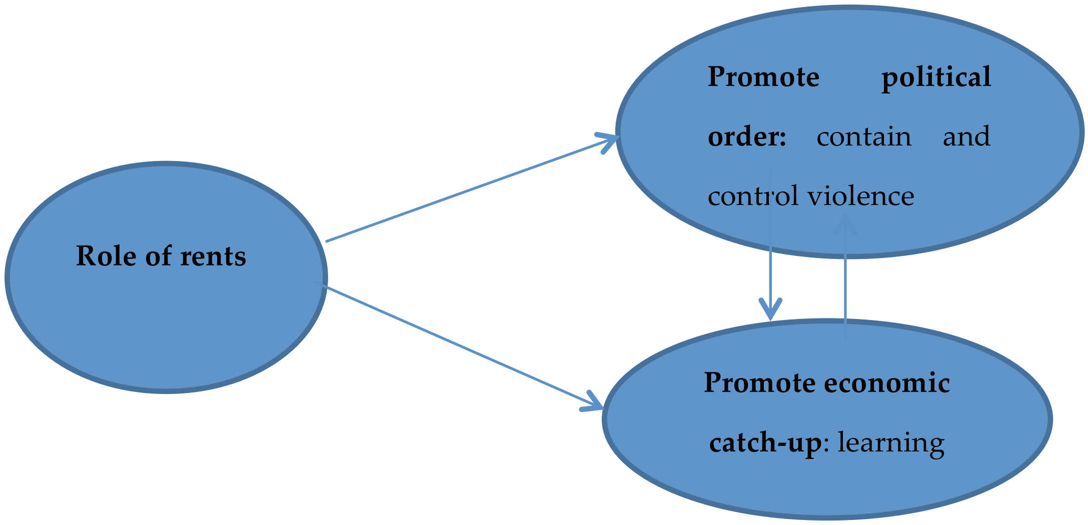
[2] 'Rents' refer to the 'excess incomes', or the 'proportion of earnings in excess of the minimum amount needed to attract a worker to accept a particular job or a firm to enter a particular industry' (Milgrom and Roberts 1992, 269). The most common form of rent creation is the establishment of a monopoly and the rents earned from such a market structure are ultimately based on the state sanctioning and defending the property rights associated with the monopoly.

[3] Elites can include: a) those in possession of valued assets in agriculture, manufacturing and services (i.e., the main capitalists); b) those who wield substantial power over the distribution and allocation of property rights (such as traditional chiefs, landlords, regional political leaders, warlords); c) those who possess authority to bargain on behalf of rural communities or organised religious communities (e.g., traditional leaders, religious leaders); and d) those who lead political organisations (Di John and Putzel 2009: 15).

degenerate into a process of dysfunctional cronyism whereby political order is maintained through networks of political clientelism, patronage and support not related to a coherent economic strategy or *where the rents deployed are not conditional upon performance criteria.*

Figure 1: the dual and interactive role of rents in the political economy of late development



There is indeed very little analysis as to how low-income countries can overcome the dangers of most rents in a polity being disbursed based on political as opposed to economic criteria. However, if elite control of rents is a central feature of asset ownership patterns in less developed countries (LDCs) and if we recognise that there is a wide and diverging variation in long-run growth among these countries, then an important issue for the political economy of development is to explain why it is the case that, in some political systems, elites are *compelled* to increase capital accumulation and productivity in order to maintain their privileges, and in many other contexts elites can maintain their privileges *without being compelled* to generate investments that enhance output growth and productivity.

Dual-Track Growth Strategies and their relevance to the design of industrial policy in late developers

If we take the problem of political economy seriously, then the main problem for strategic planning is not which types of industrial policies are inherently better, but how state decision-makers can *change* ineffective policies while maintaining non-violent political order. In fact, most influential models of political economy point mainly to how politics imposes constraints on policy-making and economic outcomes (Kohli, 1994; North et al 2007; Acemoglu and Robinson, 2012). However, these models often neglect the role that political strategies and ideas can have in *relaxing* long-standing constraints (Rodrik, 2014). Historically, the role of ideas and political and economic strategies has been important in re-shaping how the powerful view their own interests (ibid.).

One important example of how this can be achieved is the so-called dual-track growth strategy. The basic idea of such a strategy is to promote an emerging dynamic sector where competition and risk-taking are promoted (Track 1) while maintaining the bulk of the protected and/or distorted sectors, often in protected agriculture and industrial sectors, with the aim of reducing social tensions and maintaining political stability (Track 2). Examples of Track 1 strategies are export processing zones and industrial parks but can also include sectors perceived by the government (often with substantial inputs from the military) as 'strategic' in terms of either economic security, national security or both (Woo-Cummings, 1999). Such a dual-track strategy postpones confrontation with established rent-seekers while the dynamic sector drives competitive diversification of the economy and builds a pro-reform political constituency.[4] The main challenge of this strategy is to insulate/ring-fence the Track 1 sector from political and clientelist predation and capture.

In general, this strategy can be seen as a transitional path to more growth-enhancing institutional reforms. This approach is far from the neo-liberal advocacy of broad-based economic liberalisation. And it also differs from the developmental state advocacy of trying to implement South Korean-style industrial policy in every sector.

There is a range of countries that have attempted dual-track strategies. These include Malaysia, Indonesia, China, Mauritius and Brazil.[5] For example, in post-1978 China, the authorities liberalized agriculture only *at the margin* while keeping the planning system

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[4] Rodrik (2005)

[5] On Mauritius, see Findlay and Wellisz (1993), and Rodrik (1999). On Malaysia, see Bruton (1992) and Di John and Putzel (2009). On China, see Qian, (2003). On Indonesia, see Flatters and Jenkins (1986). On Brazil, see Geddes (1994) and Di John (forthcoming).

intact. Farmers were allowed to sell surplus crops freely at a market-determined price only after they had fulfilled their obligations to the state under the state order system. This approach allowed for increases in efficiency while minimising social disruptions (Lau et al. 2000).

To take another example, in Mauritius creation of the EPZs in textiles in the 1970s and 1980s generated new opportunities of trade and employment (for women), without taking protection away from the import-substituting groups and from privileged male workers. The segmentation of labour markets was particularly crucial, as it prevented the expansion of the EPZ from driving wages up in the rest of the economy, and thereby disadvantaging import-substituting industries. New profit opportunities were created at the margin while leaving old opportunities undisturbed (Rodrik, 1999).

The main policy implication from these experiences is that creating one or two growth poles can be sufficient to accelerate growth. At the same time, because such polices do not attempt to introduce broad-based reforms, they do not disrupt patronage structures that, while generating inefficiencies, are central to the maintenance of political order and stability. What is noteworthy in all of these cases is the existence of strong national political parties and organizations that underpin executive authority. Strong, disciplined national parties not only enable the state to centralize patronage and make credible bargains and side payments to contending groups, but they also provide a focal point around which collective action and lobbying can occur in a relatively predictable manner. Additionally, they are central to providing the institutional mechanisms for distributing patronage to regional elites and to important political constituencies in ways that either prevent challenges to authority or maintain the cohesion of the ruling coalition.

There is significant reasons to suggest that these types of strategies can be relevant for Ethiopia. It has been argued that one of the main impediments to expanding the productivity of such sectors as coffee and leather is the inability to develop larger farms and ranches (Tenaw et al. 2009; Dinh, 2013). This deficiency is in turn likely to be due to the lack of land markets, the power of local authorities to demand high land taxes for the expansion of emerging businesses, and the *de facto* traditional access to land. Devising strategies to allow for greater consolidation of land along with the provision of targeted infrastructure *while* finding mechanism to compensate those who might be disadvantaged in the process will be central to improving productivity and export growth in these sectors.

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